

Half-Yearly Financial Review of the Securities Industry

Intermediaries Supervision Department¹

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Summary

Overall profitability of the industry reduced in the first half of 2005 primarily due to increase in total overheads and interest expense.

Overview of the Securities Industry in the First Half of 2005

- Although the local stock market in most of the first half of 2005 was influenced by interest rate hikes and fluctuations in oil price, large Mainland IPOs launched in June 2005 substantially improved the trading activities near the end of the first half of 2005. The average daily turnover was boosted up by 26% from HK\$14 bn in May 2005 to HK\$17 bn in June 2005. In addition, Hang Seng Index also surged to its four-year high of 14,365 close to the end of the first half of 2005. In July 2005, the average daily turnover further jumped to HK\$21 bn.
- Table 1 summarized the securities industry's statistical information and financial highlights for the first half of 2005.

Table 1 – Statistical Information and Financial Position of the Securities Industry		
As at	30/6/2005	30/6/2004
Total number of securities dealers & securities margin financiers	634	667
Total number of active cash clients ¹	629,960	666,621
Total number of active margin clients ¹	76,332	75,419
Balance Sheet (HK\$ mn)		
Cash in hand and at bank ²	101,286	99,811
Amounts receivable from margin clients ³	17,333	16,008
Amounts receivable from clients and other dealers arising from dealing in securities	110,562	77,496
Proprietary positions	85,055	52,391
Other assets	73,456	51,363
Total assets	387,692	297,069
Amounts payable to clients and other dealers arising from dealing in securities	168,770	124,815
Total borrowings from financial institutions	59,880	41,642
Short positions held for own account	26,717	20,322
Other liabilities	54,147	36,183
Total shareholders' fund ⁴	78,178	74,107
Total liabilities and shareholders' fund	387,692	297,069
	6 months to	6 months to
	30/6/2005	30/6/2004
Profit and loss (HK\$ mn)		
Total value of transactions ⁵	9,111,027	8,536,063
Net securities commission income	8,637	9,956
Gross interest income	1,947	1,233
Net profit on proprietary trading	165	1,364
Other income ⁶	14,216	14,202
Total overheads and interest expense ⁷	(20,478)	(17,710)
Net profit for the period	4,487	9,045
Remarks:		
¹ Active clients are clients for whom the licensed corporation is required to prepare and deliver monthly statements of account in respect of the relevant reporting month in accordance with Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules.		
² Cash in hand and at bank includes trust monies held on behalf of clients amounting to HK\$46,037 mn (30/6/2004: HK\$43,019 mn).		
³ Average collateral coverage (the number of times the aggregate market value of securities collateral deposited by clients covers the amounts receivable from margin clients on a given date on an industry-wide basis):		
	<u>As at 30/6/2005</u>	<u>As at 30/6/2004</u>
	4.2	4.3
⁴ The value of shareholder's fund includes value of redeemable shares.		
⁵ Total value of transactions includes trading in equities and bonds both in Hong Kong and overseas.		
⁶ Other income mainly comprises corporate finance income, fund management income, intercompany charges and others.		
⁷ Total overheads include salary and staff benefits paid to non-commission based staff of licensed corporations. Commission paid to account executives and others has been netted off with commission income to arrive at the net securities commission income.		
	<u>6 months to 30/6/2005</u>	<u>6 months to 30/6/2004</u>
	(HK\$ mn)	(HK\$ mn)
Salary and staff benefits	10,113	9,016
Sources: Monthly Financial Returns submitted in accordance with the Securities and Futures (Financial Resources) Rules by securities dealers and securities margin financiers.		

¹ The objective of this paper is to provide summary financial data so that those who are interested can use these data for benchmarking, research analysis or other purposes. Observations made in this review should not be taken as definitive market commentaries.

3. Although the total value of transactions increased by 7% in the first half of 2005, the net securities commission income slightly declined due to shrinkage in net commission rate charged.
4. Overall profitability of the industry was down to HK\$4.5 bn due to substantial increase in total overheads and interest expense and lower net securities commission income and net profit on proprietary trading during the period.
5. On the other hand, amounts receivable from margin clients stood at around HK\$17 bn and average collateral coverage remained relatively

stable at around 4.2 times in the first half of 2005 as compared with the same period of 2004.

6. The significant increase in amounts receivable from and amounts payable to clients and other dealers were primarily in line with uprising market turnover in June 2005 as compared with the same month in 2004.

Business Performance of SEHK Participants

7. Table 2 summarized the overall financial performance of SEHK participants for the first half of 2005.

	6 months ended 30/6/2003	6 months ended 31/12/2003	6 months ended 30/6/2004	6 months ended 31/12/2004	6 months ended 30/6/2005
Total value of transactions (HK\$ bn)	1,976	3,938	4,763	4,680	5,400
Net securities commission income (HK\$ mn)	3,700	6,696	7,438	6,575	6,616
Net profit/(loss) from proprietary trading (HK\$ mn)	108	326	285	128	2
Net profit for the period (HK\$ mn)	607	3,377	4,997	2,057	2,056

Sources: Monthly Financial Returns submitted in accordance with the Securities and Futures (Financial Resources) Rules by securities dealers.

8. Table 3 summarized the key balance sheet items and financial performance of each category of SEHK participants for the first half of 2005.

Key balance sheet items as at	Category A*		Category B*		Category C*		All SEHK Participants	
	30/6/2004	30/6/2005	30/6/2004	30/6/2005	30/6/2004	30/6/2005	30/6/2004	30/6/2005
Amounts receivable from margin clients	275	397	6,940	8,011	5,633	4,915	12,848	13,323
Proprietary positions	897	1,134	595	664	2,629	2,915	4,121	4,713
Total shareholders' fund	9,060	10,201	10,847	16,786	15,814	16,582	35,721	43,569
Profit and loss	6 months ended 30/6/2004	6 months ended 30/6/2005	6 months ended 30/6/2004	6 months ended 30/6/2005	6 months ended 30/6/2004	6 months ended 30/6/2005	6 months ended 30/6/2004	6 months ended 30/6/2005
Total value of transactions	2,225,353	2,592,950	1,659,588	2,011,998	877,700	795,163	4,762,641	5,400,111
Total operating income	7,010	4,702	2,884	3,811	2,265	2,406	12,159	10,919
Overheads and interest expense	(3,804)	(3,713)	(1,895)	(2,952)	(1,463)	(2,198)	(7,162)	(8,863)
Net profit for the period	3,206	989	989	859	802	208	4,997	2,056

* Categories A, B and C SEHK participants are identified on a monthly basis, based on their turnover on the SEHK. Category A SEHK participants refer to the top 14 brokers by market turnover, whilst Category B SEHK participants refer to those ranked 15 - 65 and the remainders are grouped under Category C SEHK participants.
Sources: Monthly Financial Returns submitted in accordance with the Securities and Futures (Financial Resources) Rules by securities dealers

9. Comparing the end of June 2005 with that of 2004, total amounts receivable from margin clients and proprietary positions of all SEHK participants remained relatively stable. On the other hand, their shareholders' fund also advanced by 22% to HK\$44 bn in aggregate.
10. During the first half of 2005, the total value of transactions of both Categories A and B SEHK participants increased by 17% and 21% respectively. However, the total value of transactions of Category C SEHK participants declined by 9%.
11. Profitability of all categories of SEHK participants generally decreased by different magnitude. The reduction in the net profit of both Categories B and C SEHK participants was primarily attributable to the increase in overheads and interest expense by 56% and 50% respectively. On the other hand, the net profit of Category A SEHK participants was adversely affected by the substantial reduction in total operating income by 33%. ■■